



RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Legislative Liaison, a record of which is kept by the Distribution Section, Publications Branch, OAS

WASHINGTON, D.C. 20548

B-130515(4)

5-19-70

089774

RELEASED

B-130515(4)

OEO

MAY 19 1970

Dear Mr. Minshall:

As requested in your letter dated April 6, 1970, and our later discussion with Mrs. Judith Rush of your office, we are presenting the following information on bank loans made to Namax Builders, Inc., and the Bland Construction Company under the Contractor Loan Guarantee Program administered by the Hough Area Development Corporation of Cleveland, Ohio. These two contractors have defaulted on loans received under the program.

The loan guarantee program is one of a number of projects administered by Hough Development under grants totaling \$3.1 million from the Office of Economic Opportunity (OEO) under the Special Impact Program provisions contained in title I, part D, of the Economic Opportunity Act of 1964, as amended (42 U.S.C. 2763).

We obtained the following information in discussions with Hough Development officials and from the limited documentation available at Hough Development. A Hough Development official told us that the documentation developed prior to January 1969 relating to the approval of the loan guarantees for Namax and Bland was destroyed by fire. Additional information pertaining to Namax was obtained from Mr. Carl Character of the law firm of Stokes, Character, Terry, and Perry. We have not examined the financial records of Namax or Bland.

By Hough Development's guaranteeing loans which banks would otherwise be unwilling to make, construction organizations, owned and operated by persons of minority groups, are able to obtain high-risk working capital. Hough Development had OEO's approval to use \$225,000 of the grant funds to operate a revolving fund under the loan guarantee program. Of this amount, Hough Development had budgeted \$212,000 for the program. Loan guarantees made by Hough Development do not require OEO approval as long as the outstanding amounts guaranteed do not exceed, in the aggregate, \$225,000. The part of a loan to be guaranteed is subject to agreement between the bank and Hough Development. Through March 1970, the bank had required Hough Development to guarantee the entire amount of all loans made under the program.

Hough Development's eligibility requirements under the loan guarantee program provide that the contractor must agree that (1) two-thirds of his employees will be residents of the Hough area of Cleveland, (2) he will train Hough residents in construction skills, and (3) he will develop a plan for hiring subcontractors from the Hough area. Hough Development prefers, but does not require, that the contractor be a Hough area organization.

-915484/ [089774]

In addition, the OEO grant agreement requires that, before a loan guarantee can be approved, Hough Development must obtain assurance that the contractor has an adequate accounting system and internal controls to safeguard its assets.

Hough Development's proposal to OEO for funding of the Special Impact Program provided that, before a contractor's request for a loan guarantee is approved a project team consisting of a Hough Development consultant or staff member and three other persons connected with other organizations in the Hough area analyze the financial position of the contractor and his ability to meet the eligibility requirements of the program. A project team was not assembled to review the qualifications of Namax and Bland for loan guarantees. These loan guarantees, which were the first two made by Hough Development, were approved by the Hough Development's Executive Committee.

NAMAX BUILDERS, INC.

Namax Builders, Inc., was incorporated in the State of Ohio in June 1967.

Mr. Character informed us that in December 1967 the president of Namax had met with him and had indicated that Namax was in need of working capital to meet its obligations under two contracts. One contract was with United States Gypsum Company for the rehabilitation of six apartment buildings in the Hough area for a total contract price of \$453,552. The other contract was with the Crescent Construction Company, a prime contractor with the Catholic Diocese of Greater Cleveland, for the rehabilitation of three apartment buildings in the Hough area for a contract price of \$221,096. Performance under these contracts was to be completed by September 30, 1968, and August 1, 1968, respectively.

Mr. Character informed us also that he had arranged for several small loans for Namax and that he had personally loaned Namax \$1,000. After Namax reported that these loans were not sufficient to meet its working capital requirements, Mr. Character, in January 1968, arranged with one of his clients, who was to remain anonymous, for a loan of \$20,000 to Namax. Under the terms of this loan, Namax was to pay back \$30,000 on October 1, 1968. Mr. Character was to act as trustee for the anonymous lender. This arrangement was approved by resolution of the board of directors of Namax on January 30, 1968. The resolution stated, in part, that the \$20,000 loan was needed to expand the Namax labor force and to buy materials to meet its contractual obligations. Mr. Character informed us that, on February 2, 1968, he, as trustee, had disbursed the \$20,000 loan to Namax.

According to Hough Development officials, they first contacted Namax in the early part of 1968 to request Namax to hire Hough area residents as construction workers. Also, in early 1968, Namax obtained a second

subcontract with the Crescent Construction Company for \$217,591 for rehabilitating housing for the Catholic Diocese.

In the fall of 1968, Namax informed Hough Development that it had been unable to meet construction schedules. Namax requested \$100,000 from Hough Development to be used for operating capital and for paying overdue debts. Namax indicated to Hough Development that the use of untrained Hough area residents was partially responsible for its inability to meet construction schedules.

On October 25, 1968, the Hough Development's Executive Committee guaranteed the principal of a \$50,000 loan, and, on November 22, 1968, the Committee guaranteed the principal of a \$15,000 loan to Namax. Under these guarantees, the Cleveland Trust Company loaned Namax \$50,000 on October 25, 1968, and an additional \$15,000 on November 22, 1968. Both loans were for 1 year, the first payment becoming due 60 days after the date of the loan and the balance to be paid in equal monthly installments.

Although it was known that Namax was operating in the Hough area, Hough Development did not determine whether Namax met its eligibility requirements for assistance under the loan guarantee program. Also, Hough Development did not obtain assurance of the adequacy of the contractor's accounting system and internal controls although required by the OEO grant agreement. Hough Development's executive director told us that Hough Development knew that Namax was in financial difficulty and that the loan guarantees were made to Namax because Hough Development did not want Namax burdened with liens which could have serious adverse effects on the prospects of continued economic development of the Hough area and the confidence of the community.

Hough Development personnel informed us that, at the time the loans were guaranteed, the president of Namax stated that he had substantial amounts of money due from the contracts with United States Gypsum and for the Catholic Diocese work. Hough Development, however, did not attempt to evaluate Namax's financial situation.

After the loans were guaranteed, Namax provided Hough Development with information showing that, of the proceeds, \$15,180 was to be used as working capital and that the remaining \$49,820 was to be used to pay outstanding debts, including the \$30,000 due to the anonymous creditor and \$1,060 due to Mr. Character for principal and interest on his personal loan.

Hough Development officials stated that, prior to receipt of the information from Namax, they had not been aware of the \$30,000 debt but that the president of Namax assured them that the debt was legitimate and that nonpayment would result in foreclosure proceedings against Namax. These officials stated that they had contacted Mr. Character who confirmed the validity of the debt.

Mr. Character advised us that on October 25, 1968, Namax delivered checks for \$30,000 and \$1,060 to him in payment of these debts. The \$30,000 check was made payable to Mr. Character, as trustee, and the other simply to Mr. Character. Mr. Character informed us that he could not divulge the name of the anonymous creditor because of the attorney-client relationship involved. The executive director of Hough Development stated that he did not know who the creditor was but that, if he had been aware that the loan was for \$20,000, he would have attempted to negotiate a settlement of the loan for less than \$30,000.

After the loan guarantees were made, a construction consultant and an accountant were hired by Hough Development to assist Namax in the management of its company. In comparison with Namax's projected profits of \$52,200 from all its rehabilitation contracts, including the three contracts noted above, the consultant reported that no profits could be expected from the contracts and that a potential debt of over \$130,000 existed.

When Namax completed the United States Gypsum contract in November 1968, it received a final payment of \$58,000 which had been retained by United States Gypsum to ensure satisfactory completion. This money was reportedly used to pay for certain of Namax's debts. On February 14, 1969, Hough Development's Executive Committee decided against any further loan guarantees for Namax. Namax completed the work under its first contract for the Catholic Diocese project in January 1969, but the second contract was terminated in April 1969 for inadequate performance.

Because Namax did not make any principal payments and was 2 months in arrears on interest payments, the bank foreclosed on the guaranteed loans on May 26, 1969, and Hough Development as guarantor had to pay \$65,000 to the bank.

Hough Development officials believe that there is little chance that they will recover the \$65,000 from Namax. Hough Development was considering legal action but as of April 13, 1970, it had not filed a law suit. According to a Hough Development lawyer, Namax has no assets and its president could not be located.

BLAND CONSTRUCTION COMPANY

The Bland Construction Company was the first contractor to receive a loan guaranteed by Hough Development under its loan guarantee program. On September 17, 1968, Hough Development guaranteed the principal on a \$20,000 loan by the Cleveland Trust Company to Bland. The funds were to be used as working capital for completing the rehabilitation of 66 family housing units in the Hough area under a contract for \$463,200 with HOPE--Housing Our People Economically, Inc., a nonprofit housing corporation.

Hough Development officials informed us that, when the loan guarantee was made, they were aware that Bland was performing work in the Hough area and was employing some Hough residents. Hough Development did not determine, however, whether Bland was complying with the eligibility requirements of the loan guarantee program. Also, Hough Development did not comply with the provision of the OEO grant agreement which requires it to obtain assurance that the contractor's accounting system and internal controls are adequate. After approval of the loan guarantee, an accountant of Hough Development attempted to determine whether Bland had an adequate accounting system but was unable to do so because Bland would not acknowledge his request for access to the necessary accounting records. ✓

The loan terms called for Bland to make monthly payments of \$2,000 plus interest to the bank beginning in December 1968 and continuing until September 1969. In all, between December 1968 and September 1969, Bland made principal payments totaling \$6,000 and interest payments of about \$1,085. In September 1969, the bank declared the loan in default and Hough Development, as guarantor, paid the bank the remaining principal balance of \$14,000.

Under the terms of the contract between Bland and the HOPE corporation, 10 percent (about \$46,000) of the money due Bland is being retained by the HOPE corporation to ensure that the contract is completed to its satisfaction.

On November 10, 1969, Bland assigned \$5,000 of the funds being retained by the HOPE corporation to the Women's Federal Savings and Loan Association of Cleveland to satisfy a debt. On December 8, 1969, Bland entered into an agreement with Hough Development to satisfy its debt of \$14,000, plus interest, through an assignment of amounts due from the HOPE corporation.

The director of the HOPE corporation told us on April 15, 1970, that Bland should receive sufficient funds on completion of the contract to satisfy the assignment to Hough Development.

- - - -

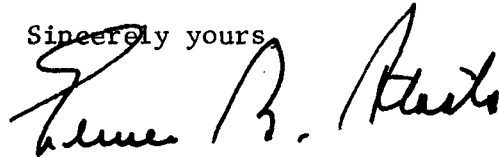
OEO, Hough Development, and other parties mentioned herein have not been given an opportunity to formally examine and comment on the contents of this report. However, in accordance with arrangements made with Mrs. Rush of your office, we plan to send copies of this report to the Director, OEO, for his information and for whatever action he deems appropriate.

Since this report contains information the disclosure of which may be prohibited by the United States Code (18 U.S.C. 1905), we shall not make the contents thereof available to the public. The referred-to statute makes it a criminal offense to disclose, among other things, the "amount or source of any income, profits, losses, or expenditures" of any person or firm.

B-130515(4)

We trust that the information contained in this report will be of assistance to you. As you know, the loan guarantee program represents only a part of Hough Development's activities. We will provide you with a copy of our report on the results of our overall review of Hough Development's activities as soon as it is released.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James B. Atch". The signature is fluid and cursive, with a large initial "J" and a long, sweeping tail.

Comptroller General
of the United States

The Honorable William E. Minshall
House of Representatives